Manager Projects
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

9 July 2010

Dear Sir/Madam

Proposed Revised Access Arrangement

We refer to the Economic Regulation Authority's ("**ERA**") notices of 15 and 16 April 2010 inviting submissions on DBNGP (WA) Transmission Pty Ltd's ("**DBP**") proposed revisions to the Access Arrangement and Access Arrangement Information for the DBNGP in relation to the period 2011 to 2015 ("**Proposed Access Arrangement**").

We set out below, in broad terms, the interest of Wesfarmers Chemicals, Energy & Fertilisers Division ("**Wesfarmers**") in the Proposed Access Arrangement.

CSBP Limited ("**CSBP**") and Wesfarmers Energy Limited ("**WEL**") are part of Wesfarmers and are significant users of natural gas as a feedstock and energy source for the production of chemicals, fertilisers, LPG, LNG and power generation. The total usage of natural gas by CSBP and WEL is more than 70 terajoules ("**TJ**") per day across at least six separate contracts ranging from less than 1 TJ per day to more than 30 TJ per day. This gas is all delivered via the DBNGP and a significant portion of the transmission capacity is contracted directly with DBP.

- CSBP currently uses natural gas for the production of ammonia, ammonium nitrate, sodium cyanide and fertilisers and expects to require increasing quantities in the longer term. These products all support industry that is critical to the Australian economy such as metals mining (iron ore, gold and nickel), minerals processing (gold and nickel), construction and agriculture. Each of CSBP's manufactured products is globally traded and therefore is exposed to national or international competition. Further, natural gas is used by CSBP predominately as a chemical feedstock rather than a fuel source and, as such, access to competitively priced natural gas is imperative.

- WEL uses natural gas for the production of LPG and LNG at its Kwinana production facilities. The ongoing production and supply of LPG and LNG is critical to domestic, commercial, industrial and mining users throughout Western Australia ("**WA**") for applications such as transport fuel, heating and power generation. These products compete against other refined liquid fuels that are traded globally and hence, competitively priced natural gas is essential for their continued viability.

Against this background and taking into account the national gas objective with which, inter alia, the provisions of any access arrangement must be consistent pursuant to the National Gas Rules ("**NGR**"), we make the following submissions on the Proposed Access Arrangement. We have addressed the matters highlighted in the Dampier to Bunbury Natural Gas Pipeline: Proposed

Revisions to the Access Arrangement Issues Paper dated 7 May 2010 issued by the ERA ("**Issues Paper**") using the headings from the Issues Paper.

Summary:

In summary, we consider that the Proposed Access Arrangement contains overly aggressive positions with respect to forecast capital and operating expenditure and an overly conservative position in relation to forecast demand, all of which will result in a higher reference tariff than is appropriate.

Request:

Given the effect of these positions on the reference tariff, and because of the limits placed by the NGR on variation of a reference tariff during an access arrangement period, we submit it is crucially important that the ERA scrutinises the figures and approaches contained in the Proposed Access Arrangement to ensure that they are appropriate and consistent with the NGR. If the ERA does not propose to vary the positions with respect to capital expenditure, operating expenditure and demand before approving the Proposed Access Arrangement, we suggest that the ERA should include one or more trigger events in the access arrangement for the 2011 to 2015 period which enable adjustment of the reference tariff if any of the forecasts contained in the Proposed Access Arrangement prove, at any time during the 2011 to 2015 period, to vary substantially from the actual position (pursuant to rule 51 of the NGR).

1 Special Circumstances applying to the DBNGP

2004 Shipper Contract renegotiations on the understanding that tariffs would decline in 2016

As noted in paragraph 25 of the Issues Paper, on 1 January 2016 the tariffs payable under gas transportation contracts will revert to the reference tariffs for the reference service under the access arrangement that is the "closest equivalent Full-Haul Service to the T1 Service" as at 1 January 2016. Also, as noted in paragraph 26 of the Issues Paper, the parameters of the access arrangement for the period 2011 to 2015 will affect the subsequent access arrangement.

In taking part in the renegotiation of their shipper contracts in 2004, along with many other shippers, the understanding of the relevant Wesfarmers entities was that they were agreeing to an uplift in the cost of their transportation service on the basis that such increase would apply for a period of time required to provide financial stability to DBP, and then revert in 2016 to the reference tariff, which was assumed to remain on a lower glide path. We wish to note this matter as context for the submissions on the revenue and pricing matters contained below.

2 Pipeline Services

A T1 Service should be offered as a reference service

As noted in paragraph 31 of the Issues Paper, R1 Service is the only type of reference service offered under the Proposed Access Arrangement.

We understand that the R1 Service is materially different to, and is less certain, has lower priority, and is more restrictive than, the T1 Service (to which it is understood the majority of the DBNGP has been contracted). Further, the proposed amendments to the non-tariff components of the reference service contained in the Proposed Access Arrangement tend to favour DBP as against the shipper, and these, together with the significantly higher reference tariff, will, in our opinion, combine to result in most, if not all, of the market for capacity on the DBNGP finding the R1 Service to be unattractive.

Therefore, we have considerable doubts whether the R1 Service is a service "*that is likely to be sought by a significant part of the market*" as required by rule 101 of the NGR, and further whether a T1 Service should be offered as a reference service.

This will become a more significant issue post 2015 and we believe DBP ought to be obliged to offer a T1 reference service (as this is a service sought by a large part of the market) by no later than 1 January 2016, but it may be appropriate for this service to be available as a reference service prior to this date.

Request: We would be concerned if DBP offered both the T1 and the R1 reference services and sought to provide a different tariff for each, because it is likely that in such case DBP would submit that a lower cost be allocated to the R1 Service and correspondingly a higher price be paid for the T1 Service. In our view, such a result may create a false pricing structure and be punitive to shippers, because there is unlikely to be any demand for the R1 Service. As a result, we submit that if a T1 Service is offered, it should be the only reference service. In addition, no decisions on reference services for the 2011 to 2015 period should prevent a T1 reference service being offered from January 2016.

3 Capital Expenditure and Depreciation

Assume ERA scrutiny of figures

Given that capital expenditure is a major driver of the increase in the reference tariff proposed under the Proposed Access Arrangement, the amounts of capital expenditure described in the Proposed Access Arrangement requires significant scrutiny. In particular, a more detailed explanation is required for the amount of $40.86 million in the category "Other depreciable assets" for 2011 forecast capital expenditure in Table 12 of DBP's proposed Revised Access Arrangement Information ("**Proposed AAI**"). This amount comprises a significant proportion of the total forecast capital expenditure for the period 2011 to 2015 and confirmation is required that such capital expenditure meets the requirements under the NGR.

Request: It is assumed that the ERA will seek evidentiary detail to evaluate the efficacy of the figures contained in the Proposed Access Arrangement, both in respect of the capital expenditure and the depreciation, to determine whether they satisfy all the requirements of the NGR, and therefore we have not made detailed submissions on these matters.

4 Rate of Return

Rate of Return should be lower

We are concerned by the large increase in the rate of return proposed by DBP in the Proposed Access Arrangement as compared to that accepted by the ERA in the previous access arrangement.

WACC: We consider that the risk profile faced by DBP is low given DBP's approach of not building any uncontracted capacity. Further, other WA pipelines face much higher commodity and counterparty risk than DBP, particularly as most end users of the services provided by DBP do not have any reasonably available energy alternatives.

Against this background, the ERA's recent decision in respect of the rate of return for the Goldfields Gas Pipeline ("**GGP**") (being a real pre Tax WACC of 7.70%) is relevant. The rate of return in respect of the DBNGP should be lower than that in respect of the GGP for the following reasons (among others).

- In our view, DBP has a lower percentage exposure to industries reliant on volatile commodity prices than Goldfields Gas Transmission Pty Ltd.
- DBP only builds capacity on the basis of long term supply contracts.
- The references (in DBP's Submission 8) to the questionable financial viability of some of DBP's customers should be irrelevant because those customers are wholesalers and the transportation requirements of the customers of those wholesalers will continue to exist, even if the particular wholesalers themselves no longer exist.

The high rate of return proposed in the Proposed Access Arrangement is not commensurate with the low risk profile for DBP and it appears that a lower rate of return would be more appropriate.

Imputation credits: We are surprised at DBP's proposal, with regard to the calculation of the proposed rate of return, that the value of imputation credits is zero. Although there are varying views in the investment community on the precise treatment of imputation credits, it is our view that they are valuable.

CPRS: It is noted that among the risk factors described by DBP to support the rate of return in the Proposed Access Arrangement is the "*risk associated with the government response to climate change*", which is described, in paragraph 15.24 of DBP's Submission 8 as the "*principal regulatory risk to which the DBNGP is exposed at the present time*". Given that the government has clearly stated that it will not consider an emissions trading scheme until at least 2013, and that the government's previously proposed scheme implicitly allowed a lead time of 18 months from legislation to start date, we do not consider that this is a reasonable risk to account for in respect of the 2011 to 2015 period.

Request: It is assumed that the ERA will undertake a full examination of the various values and methods used by DBP in proposing the rate of return in the Proposed Access Arrangement and therefore we do not propose to make further detailed submissions on these matters.

5 Operating expenditure

Assume ERA scrutiny of figures

Lack of detail: The ERA's comments in paragraph 78 of the Issues Paper are noted and we share the concern that the lack of detail provided by DBP with respect to actual operating expenditure for the period 2005 to 2010 may hinder an adequate assessment of the forecast operating expenditure under the Proposed Access Arrangement. The need for such assessment to be fully informed and undertaken in detail is clear from the significant difference between actual operating expenditure from the 2005 to 2010 period and the forecast operating expenditure contained in the Proposed Access Arrangement. The implications of the recent structural change in DBP to directly employ resources (rather than to meet the requirements through outsourcing) need to be more clearly defined in the actual expenditure as one would assume that this was done to increase efficiency and any improvements should be reflected in the future expenditure. Without limiting the general requirement for a thorough assessment of operating expenditure over the entire period, further explanation is required of the significant increase in Operating Expenditure from $88 million in 2010 to $107 million in 2011 as shown in 6.2 of Submission 12.

CPRS: We query whether it is the appropriate to include an amount with respect to the government's formerly proposed CPRS legislation in forecast operating expenditure (as stated in paragraph 9.3(d) of the Proposed AAI and section 6 of Submission 12), given that the government has expressed its intention to delay introduction of the CPRS legislation until after 2012, making it unlikely that any CPRS will have a significant impact during the 2011 to 2015 period (the government's previously proposed CPRS legislation implicitly allowed a lead time of 18 months from the passage of the legislation to the start date). In this regard, we note that DBP appears to have also taken into account the impact of the formerly proposed CPRS legislation in determining forecast demand and the risks relevant to rate of return (in DBP's Submission 7 and Submission 8), which is a driver of the higher reference tariff under the Proposed Access Arrangement.

Fuel gas: It is not clear whether fuel gas provided by shippers on the DBNGP has been taken into account in the forecast expenditure on fuel gas. Further, in respect of the first item listed in Issue 7 of the Issues Paper, which raises the question of whether the arrangements for fuel gas are reasonable and reflect existing arrangements, it is understood that in 2009 DBP accepted a request by its fuel gas supplier to pay a price above its contracted price for future fuel gas supplies. Objections were raised with DBP at the time to any pass through from DBP of any such increased prices that DBP may volunteer to pay for fuel gas. We strongly suggest that it is not reasonable for this voluntary increase in fuel gas prices to be passed through as operating expenditure (which contributes to an increased reference tariff).

Inconsistent assumptions: It also appears that DBP has assumed an increase in labour demand in the minerals and energy sector to propose an increased labour cost factor in the calculation of operating expenditure, but has then, in contrast, submitted that uncertainty in volume growth in the minerals processing industries and delay of projects due to the global financial crisis are factors which support a low demand forecast (see DBP's Submissions 7 and 12).

Request: We assume that the ERA will undertake a full examination of DBP's submissions on operating expenditure in the Proposed Access Arrangement and therefore do not propose to make detailed submissions on these matters.

6 Demand

Forecast demand is unreasonably low

It is noted that an under-estimate of forecast demand contained in the Proposed Access Arrangement will result in reference tariffs being substantially higher than they should be. In this regard, we are concerned at the low levels of forecast growth in demand contained in the Proposed Access Arrangement. While we do not expect demand to grow during the 2011 to 2015 period to the same extent as during the 2005 to 2010 period, we find the substantial drop in forecast growth unreasonable.

CPRS: In particular, we do not believe the government's formerly proposed CPRS legislation should be considered in determining forecast demand (see DBP's Submission 7), as discussed in sections 4 and 5 above.

LPG content: We wish to query the assumption of "*no LPG content*" contained in paragraph 8.2(b)(D) of the Revised AAI, which is at odds with our own commercial assumptions. We also query the reasonableness of the factor in paragraph 7.1(f) of DBP's Submission 7 in determining the low forecast volumes in the Proposed Access Arrangement, being "*decreased LPG content will result in decreased throughput for Alinta as it transports gas to the Wesfarmers LPG Plant*", as again, we do not foresee a significant decrease in LPG content during the 2011 to 2015 period. To the extent that there is LPG content, we will use transmission capacity in relation to such content. Therefore, we are concerned that DBP has not included this volume in its forecast demand (and therefore has over-estimated the tariff required to recover the relevant cost base).

Future projects: It does not appear that the forecast demand under the Proposed Access Arrangement takes into account BHP's Macedon project and any other future projects that may begin delivering gas into the DBNGP as a result of the passage of the *Gas Supply (Gas Quality Specifications) Act 2009* (WA) ("**Specifications Act**"). We would also request, as was stated in the Office of Energy's presentations on the changes to the gas specification, that the ERA ensures that there is no double counting of pipeline capacity losses for which DBP should be compensated by the gas supplier under the Specifications Act, included in the demand/capacity calculations.

Other services: It does not appear that DBP has taken into account other services in calculating forecast demand, such as those arising from LPG content, Tx service, Tp service and other non-reference services. The revenue streams generated from these services should be taken into account to reduce the amount of revenue sought to be recovered by way of the reference tariff. An alternative is to provide a rebate to shippers, but this is seen as a complicated option to implement.

Request: We assume that the ERA will investigate and alter the demand forecast, include other services that provide revenue and exclude any costs for CPRS. If the ERA does not propose to amend the figures provided by DBP for forecast demand at this stage, then it is suggested that the ERA should address this concern by including, by amendment to the Proposed Access Arrangement, the occurrence of a nominated increase in volumes as a trigger event for DBP to provide revisions to the access arrangement which re-set the reference tariff consistent with the increased volumes (pursuant to rule 51 of the NGR).

7 Tariffs and Tariff Variation Mechanism

Reference Tariff

It is agreed that a 40 per cent increase in the Reference Tariff seems high and out of line with the general trend in increases in WA in the current climate. The absolute tariff has a direct impact on the affordability of gas in WA which impacts both industry that is competing with globally priced products and domestic consumers' gas and power costs.

The proposal to reduce the Commodity tariff to less than 5 per cent of the total tariff further increases the average tariff as typically, pipeline capacity loading operates at less than 100 per cent.

Request: The ERA is requested to closely examine the cost and demand factors as discussed above to ensure that any increase in the tariff is minimised and that an end result of significantly less than 40 per cent is achieved. It is also requested that, if the Commodity tariff percentage is reduced to five per cent, there should be a further impact on lowering the rate of return as described above, as a low Commodity tariff percentage lowers the revenue risk for DBP.

Tariff Variation Mechanism

It is noted that the proposed Tariff Variation Mechanism is a direct CPI linked formula. Productivity improvements by DBP should mean that cost and therefore tariff increases beyond the first year of the term can be limited to something less than CPI.

Request: It is requested that the Tariff Variation Mechanism is structured to ensure that cost increases are lower than CPI for the term of the Access Arrangement.

8 Incentive mechanism

Query the absence of an incentive mechanism

The absence of an incentive mechanism under the Proposed Access Arrangement is noted and we are concerned that this will lower the incentive upon DBP to reduce costs during the 2011 to 2015 period.

9 Non-tariff Components

Amendments favour DBP

Unlikely to be acceptable: The general trend of the changes to the non-tariff components in the Proposed Access Arrangement shift in favour of DBP. Such changes mean that the R1 Service Terms and Conditions differ substantially from the standard shipper contract published on DBP's website, which is the standard contract used by the market. We consider that the R1 Service is therefore unlikely to pass the test in rule 101 of the NGR (as discussed above at paragraph 2). There does not appear to be a basis for the ERA to accept an access arrangement which offers a type of service, and terms and conditions for that service, which are not generally accepted by the market.

Inconsistent with existing arrangements: There are doubts as to whether the R1 Service can actually be offered to anyone because, in our view, there are strong arguments that some of the key provisions of the R1 Terms and Conditions are inconsistent with the rights of existing shippers. In particular, we query how DBP can purport to amend the curtailment plan in the Proposed Access Arrangement so that it differs from the curtailment plan in its contracts with all other current shippers.

We are strongly of the view that many of the changes proposed to the non-tariff components of the reference service under the Proposed Access Arrangement should be rejected; however, given that the R1 Service is not a type of service which is likely to be sought by Wesfarmers, we do not propose to undertake a full analysis of, and make detailed submissions on, the non-tariff components of the reference service.

Capacity Trading Requirements

Objection to clause 6.4

As a preliminary point in relation to the issue of capacity trading requirements under the Proposed Access Arrangement, it is noted that the references to clauses 24.3, 24.3 and 24.4 of the Access Contract Terms and Conditions appear to be incorrect.

Clause 6.4 of the Proposed Access Arrangement purports to terminate a transferor shipper's contract upon the transfer of capacity. We submit that such an outcome is unreasonable and, among other consequences, may give DBP the opportunity to renegotiate terms if the transferor shipper wishes to resume its traded capacity.

Further, clause 6.4 of the Proposed Access Arrangement appears to be in direct conflict with clauses 27.8, 27.9 and 27.7(d) of the Access Contract Terms and Conditions (which are substantially in the form of clauses 27.8, 27.9 and 27.7(d) under the current reference service contract). Clause 27.8 provides that, upon a transfer of capacity with the Operator's consent, the transferor shipper's contract remains "*in full force and effect*", and is simply amended so that the transferor shipper's contracted capacity is reduced by the transferred amount. Clause 27.9 provides for the circumstances in which the transferor shipper may resume the traded capacity and that, upon doing so, the capacity will be subject to the terms and conditions of the transferor shipper's original shipper contract. Clause 27.7(d) provides the transferor shipper with the opportunity to cure a default of the transferee shipper.

Request: We submit that clause 6.4 of the Proposed Access Arrangement should be deleted, and capacity trading continues to occur in accordance with the relevant provisions of the current reference service contract.

We do not intend for this submission to indicate our acceptance of or support for the other amendments proposed with respect to capacity trading in the Proposed Access Arrangement (including the amendments to the reference service contract terms); however, we do not propose to make any further submissions on these matters. Wesfarmers reserves the right to make submissions in relation to capacity trading requirements in respect of any future access arrangement period.

We request that the ERA takes full account of the comments and requests included in this submission. Throughout our submission we have assumed the ERA will undertake assessments of various technical and financial matters. If there is specific input that Wesfarmers can provide to assist this assessment we will be happy to do so. If the ERA has any questions in relation to the submission, please do not hesitate to call me on 08-93129315.

Yours sincerely

Tom O'Leary

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